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Auditor Reviews of Changing Prices Disclosures*

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Research Purpose and Methodology

This research project was sponsored jointly by the Financial Accounting Standards Board and the American Institute of Certified Public Accountants. The objectives of the research and the steps followed in conducting the project are described in this introductory section of the report.

Background

In September 1979, the FASB issued Statement of Financial Accounting Standard No. 33, *Financial Reporting and Changing Prices*.¹ This statement is an experimental standard on accounting for the effects of changing prices. It requires selected public companies to report changing prices disclosures as supplemental information to their financial statements. Although this supplemental information is unaudited, auditing standards² require auditors to consider this information and, in certain circumstances, to report on it.

Because of the experimental nature of SFAS 33, the FASB has encouraged research to assess costs and benefits of changing prices disclosure requirements. This project is one of fifteen research studies being monitored by the FASB in assessing the SFAS 33 experiment. It represents the only FASB-sponsored project that is focused specifically at audit issues and that provides for auditor input.

The American Institute of CPAs, through its Auditing Standards Division, also has encouraged research directed toward improving standards and procedures for auditors who must deal with changing prices disclosures.

In assessing the SFAS 33 experiment, it is important to recognize the views of all interested groups: users, preparers, and auditors. The results of this study—the data and insight from an auditor's perspective—should be considered in light of other related research concerning the usefulness of changing prices disclosures.

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Objectives

Statement on Auditing Standards (SAS) 27 and SAS 28 provide general standards for auditors in meeting their responsibilities with respect to a client's changing prices disclosures. However, these auditing standards do not specify detailed procedures to be used in reviewing the disclosures, nor do they address special problems that may arise during the review process. Because of the experimental nature of SFAS 33 and the general nature of SAS 27 and SAS 28, little is known about the actual review techniques used by CPAs. The overall objective of this research was to examine the actual experience of CPAs in conducting such reviews.* Thus, this is a descriptive study dealing with auditors' perceptions, responsibilities, and experience in reviewing SFAS 33 disclosures.

More specifically, this research was designed to accomplish five objectives.

1. Determine the extent and impact of SFAS 33 changing prices disclosures.
2. Identify the costs involved in the review process.
3. Identify the techniques and procedures currently used by CPAs in conducting reviews.
4. Analyze special problems encountered in conducting reviews.
5. Identify auditor perceptions concerning the usefulness and auditability of SFAS 33 disclosures.

The results of this study may assist the FASB in developing reporting requirements that will provide more useful information. Such reporting requirements might help to simplify auditor reviews and, thereby, lower the costs of disclosure. In addition, this research may provide useful data for the Auditing Standards Board in considering amendments to, or interpretations of, SAS 27 and SAS 28.

Methodology

The first step in conducting the research was to review guidance Materials developed by CPA firms for SAS 27 and SAS 28 reviews. Materials from seven accounting firms were examined. In addition, FASB statements, statements on auditing standards, articles, position papers, company annual reports, and other publications dealing with financial reporting and changing prices were studied.

A second step was to conduct in-depth interviews with national office partners and personnel of three major CPA firms. These interviews, held in New York City, were with individuals who are heavily involved with the research topic. Prior to conducting the in-depth interviews, the researchers prepared a detailed checklist of questions based primarily on CPA firm guidance materials. These interviews proved extremely useful in clarifying key issues and in identifying additional questions, which were then used in the development of a questionnaire.

* The term *review* is used in this report in the context of the normal English language and not in the technical sense of, for example, "compilation and review" as defined in Statements On Standards For Accounting and Review Services No. 1, "Compilation and Review of Financial Statements" (Accounting and Review Services Committee, December 1978).

The third step in the research process was to develop a comprehensive questionnaire designed to elicit responses from a representative sample of audit practitioners with clients that currently disclose SFAS 33 data. Once the questionnaire was developed, it was sent to each of the partners interviewed, to representatives of the FASB and AICPA, and to academic colleagues for review.

The fourth step was to conduct a pilot test of the questionnaire. Again, interviews were conducted with key personnel of two different CPA firms, this time in Salt Lake City offices. Based on these pilot tests, additional minor modifications were made to the questionnaire.

Questionnaires were distributed to 172 potential respondents.* Of these, 126 were returned, a 73 percent response rate. Because of missing pages, seven questionnaires were not usable. The data and comments received, along with information obtained during interviews, provide the basis for the conclusions of this report, which are described in the next section.

Results of Research

The results of the research are grouped into five categories: perceived client interest and involvement with SFAS 33 disclosures; nature, extent, and impact of CPA involvement with changing prices disclosures; specific techniques used by CPA firms in performing SAS 27 and SAS 28 reviews; special problems encountered by auditors; and auditor perceptions concerning the usefulness and auditability of changing prices data.

Perceived Client Interest and Involvement with SFAS 33 Disclosures

Although 98 percent of the audit clients in the sample met the SFAS 33 size criterion and disclosed changing prices data in all four years (1979-82) covered by the study, auditors perceived that their clients have little interest in SFAS 33 disclosures. Specifically, only six clients reported changing prices data on a comprehensive basis. Other clients essentially provided the minimum required disclosures specified by Statement 33. Of the 118 auditors responding to the question concerning client interest in the disclosures, 104 clients were evaluated by their auditors as complying only because of the disclosure requirement, 12 were evaluated as having moderate interest in the changing prices disclosures, and only two were evaluated as having sufficient interest to frequently base managerial decisions on inflation-adjusted data.

Given the low level of interest in SFAS 33 disclosures, it is not surprising that most companies comply with the minimum disclosure requirements, using easily applied measurement methods that have a low relative cost. For example, indexing is the most common method used by companies to compute the current cost of property, plant, and equipment (PPE). In computing the current cost of PPE, 59 percent of the companies used specific price indices, 3

* A representative sample of companies reporting under SFAS 33 was drawn from the FASB data base and the CPA firms that audit these companies were identified. Nine major CPA firms were involved. A cover letter and several questionnaires were sent to a partner in the national office of each of the nine firms who in turn forwarded the questionnaires to engagement partners or managers directly involved with the particular client companies in the sample.

percent used direct price quotes, 12 percent used general indices such as the CPI, 11 percent used annual appraisals, 7 percent used appraisals in the first year with indices in subsequent years, and 4 percent used internally-developed indices. The principal types of specific price indices used were *U.S. Producer Price Index* (38 percent), *Handy-Whitman Index* (17 percent), and the *CPI-U* (17 percent).*

With respect to inventory, current costs were most often estimated using FIFO inventory costing (53 percent); standard costs were used in 17 percent of the companies; and published indices were used by another 11 percent of the companies.

In summary, it can be concluded that although large companies do comply with SFAS 33, most are perceived by their auditors as having little interest in the data and report the data only because of the FASB requirement. In general, companies do not appear to use changing prices data for internal managerial purposes, provide only the minimum required disclosures, and use simplified methods to estimate current costs of PPE and inventory (i.e., indices for PPE and FIFO for inventory).

Nature, Extent, Costs, and Impact of CPA Involvement with Changing Prices Disclosures

SAS 27 and SAS 28 require that auditors be involved with their clients' changing prices disclosures. Because SAS 27 and SAS 28 offer only general guidance to auditors, this research gathered evidence on the extent of CPA involvement, the costs incurred, and the impact of auditors' efforts.

As expected, in the first year of compliance, auditors were involved extensively in assisting their clients in preparing the changing prices disclosures; in subsequent years, auditor involvement was limited generally to reviewing the data. Specifically, the percentage of auditors who assisted their clients in preparing changing prices disclosures decreased from 54 percent in 1979 to 23 percent in 1982. As a result of this reduced involvement, auditor time decreased each year. Average chargeable hours involved in helping clients prepare changing prices disclosures and in conducting SAS 27 and SAS 28 reviews were 104 hours in 1979, 84 hours in 1980, 71 hours in 1981, and 68 hours in 1982. For 90 percent of the reviews, the procedures represented less than 2 percent of "total audit time."

In respect to the hours charged to the reviews of changing prices disclosures, senior staff accounted for 43 percent, supervisors/managers 27 percent, junior staff worked 23 percent, and partners accounted for only 7 percent. Using the average chargeable hours mentioned above and constant billing rates of \$45 per hour for junior staff, \$65 for senior staff, \$100 for supervisor/manager, and \$150 for partners, the average cost to clients of auditor involvement with the changing prices data was \$7,883 in 1979, \$6,367 in 1980, \$5,381 in 1981, and \$5,154 in 1982.

* The Consumer Price Index-Urban suggests a national price level by calculating the average price of a "market basket" of many commodities commonly purchased by urban and suburban households. The U.S. Producer Price Index measures price changes on approximately 2,800 goods sold in large quantities by primary producers to wholesalers and distributors. The Handy-Whitman Index is a property valuation index that is used in the public utility industry to estimate construction costs.

Measuring the impact of auditor association with changing prices disclosures was more difficult than measuring costs. Impact (effectiveness) can be measured accurately only if quality, extent of the disclosures, and degree of compliance can be assessed both with and without auditor involvement. Because involvement is required, the surrogate measurement used was whether auditors initiated adjustments to the companies' changing prices disclosures or modified their own reports because of material departures from SFAS 33 guidelines.

With respect to adjustments, the performance of SAS 27 and 28 procedures resulted in modified disclosures in 55 percent of the companies for one or more years. Most of these adjustments involved correcting clerical errors and problems with the translation of data from foreign subsidiaries. As a result of the adjustments, some reported current cost number was changed for 34 percent of the clients, some constant dollar number was changed for 21 percent of the clients, a narrative disclosure was changed for 14 percent of the clients, a reported holding gain and/or loss was changed for 15 percent of the clients, a reported monetary gain or loss was changed for 12 percent of the clients, reported income from continuing operations was changed for 9 percent of the clients, and a reported "lower recoverable amount"* was changed for 4 percent of the clients.

In no case were auditor reports modified (i.e., a third paragraph added) to call attention to omissions, material departures from SFAS 33 guidelines, or because of the inability to perform SAS 27 and 28 procedures. Most auditors agreed, because of the general nature of the standards and the subjective nature of the changing prices data, that departures, errors, or omissions would have to be extremely significant before a modification of the audit report would be considered. Auditors suggested that materiality guidelines for changing prices data are not nearly as strict as those for data contained in the primary financial statements.

Based on these results, it is apparent that the cost of auditor involvement with changing prices disclosures is comparatively low and represents only a small percentage of total "audit" cost. Involvement does result in some general adjustments, although mostly clerical, to the supplemental disclosures. In no case were there omissions or departures from SFAS 33 guidelines that were considered material enough to justify modification of the auditor report.

Specific Techniques Used by CPAs in Performing SAS 27 and SAS 28 Reviews

As indicated earlier, SAS 27 and SAS 28 provide only general guidelines as to how auditors are to meet their responsibilities with respect to clients' changing prices disclosures. As a result, one of the major purposes of the research was to determine what specific procedures are being used and whether or not these procedures are consistent across CPA firms.

To determine existing procedures, CPA firms that have SFAS 33 clients were contacted and asked to send copies of the programs they use in meeting

* SFAS No. 33 states that "If the recoverable amount for a group of assets is judged to be materially and permanently lower than historical cost in constant dollar or current cost, the recoverable amount shall be used as a measure of the assets."

SAS 27 and SAS 28 responsibilities. Seven of the nine CPA firms with 12 or more SFAS 33 clients sent programs; one replied they did not have a specific program; and one firm did not respond. Once received, these programs were analyzed and compared for consistency. Most programs were general, merely rephrasing the overview procedures outlined in SAS 27 and SAS 28. On the basis of these documents and interviews with audit partners, it was determined that auditors use the following six procedures in meeting their responsibilities:

1. Inquiring of management and other client personnel.
2. Checking mathematical accuracy of the current cost and constant dollar computations.
3. Performing reasonableness tests.
4. Comparing SFAS 33 disclosures with those in the audited financial statements.
5. Reading narrative explanations.
6. Cross-checking data to source documents.

Of these procedures, numbers 1, 4, and 5 are specifically required by SAS 27 and SAS 28. It is not surprising, therefore, that inquiries of management and other client personnel were deemed by auditors to be most important. On average, 23 percent of total chargeable hours were spent in this activity. Most inquiries were made of the client's senior accounting staff and controllers; there is little interaction with nonaccounting personnel. Specifically, less than 5 percent of the respondents stated that they ever questioned engineers or appraisers whereas over 64 percent indicated that inquiries were made of senior accounting staff and controllers.

While the programs of most CPA firms did not specify types of inquiries made, one program did enumerate specific areas for inquiry. Based on that program and on initial interviews, the researchers identified several potential topics covered in discussions with client personnel. On a scale of 1 (no emphasis) to 5 (very strong emphasis), respondents ranked specific inquiries as follows:

Nature of Inquiry	Average Score
1. Are changing prices disclosures consistent from year to year?	4.262
2. Do current cost and constant dollar computations comply with SFAS 33 guidelines?	4.227
3. Are preparer(s) and reviewer(s) knowledgeable about changing prices disclosures?	4.050
4. What significant assumptions are made by clients in preparing changing prices disclosures?	3.983
5. Are assumptions made by the company in preparing the data consistent with the nature of the business?	3.806
6. Are client's computations internally reviewed and rechecked?	3.704

7. Are the sources of the current cost data appropriate?	3.655
8. What methods are used in computing current cost amounts?	3.649
9. What methods are used in providing constant dollar amounts?	3.550
10. How does the client treat disposals of business segments?	3.487
11. Who prepares the disclosures?	3.413
12. How are monetary assets and liabilities classified?	3.303
13. What assumptions are made about inventory turnover?	3.056
14. What shortcut techniques, if any, are used in computing changing prices disclosures?	3.047
15. How are the "lower recoverable amounts" of assets calculated?	2.947
16. What considerations are given to the homogeneity of assets?	2.857

Checking the mathematical accuracy of client's computations was the second most time-consuming procedure used by auditors. Over 97 percent of the respondents indicated that they test-checked mathematical accuracy, spending, on average, 21 percent of chargeable hours in this activity. Most checking involved recalculating adjustments made through using the CPI-U and other more specific indices.

Eighty-seven percent of all respondents indicated they performed reasonableness tests in complying with SAS 27 and SAS 28. On average, reasonableness tests consumed 19 percent of total chargeable hours. Specific reasonableness tests included the following:

1. Comparing the disclosed monetary gain or loss with the net monetary position times the average rate of inflation.
2. Comparing constant dollar depreciation with the percentage increase in restatement of fixed assets times historical cost.
3. Comparing the percentage change from historical costs to current cost for fixed assets with the average yearly rate of increase in the value of fixed assets times the assets' lives.
4. Comparing the percentage changes in the constant dollar and current cost amounts with the general inflation rate.
5. Comparing the relationship between historical cost, constant dollar, and current cost amounts in prior years to that of the current year.
6. Performing analytical reviews of significant fluctuations.

Although 87 percent of responding auditors indicated that they performed one or more of the above tests, all indicated that less emphasis was placed on these tests than on the other procedures.

Even though the average percentage of total chargeable hours consumed in

comparing SFAS 33 disclosures to audited financial statements for consistency was only 16 percent, because it is required, all respondents indicated that this was a procedure they always performed.

The specific comparisons made, with their respective scores, were:

Nature of Comparison	Average Score
1. Examining the consistency between the basic data in the primary financial statements with that used in the changing prices disclosures.	4.274
2. Examining the consistency of methods, indices, and assumptions used from year to year.	4.188
3. Examining the consistency of the service lives of property, plant, and equipment with those assumed in the changing prices disclosures.	3.404
4. Examining the consistency of the inventory turnover assumptions used in changing prices disclosures with those in the primary financial statements.	3.229
5. Examining the consistency between the use of "lower of cost or market" in the primary financial statements and adjustments to "lower recoverable amounts" in the changing prices disclosures.	3.045

The remaining two procedures used by auditors were reviewing narrative explanations and test-checking the data to source documents. On average, reviewing narrations consumed 11 percent of the total chargeable hours. To assess what auditors look for when reading narrative disclosures, they were asked to indicate the emphasis placed on the completeness of various aspects of the disclosures. The following are average scores with respect to evaluating management's narrative explanations:

Nature of Reading	Average Score
1. Making sure there are no material misstatements of fact.	4.483
2. Making sure there are no material omissions.	4.235
3. Making sure there are no material inconsistencies between changing prices disclosures and data presented in the audited financial statements or elsewhere in the annual report.	4.139
4. Making sure all explanations are logical.	4.000
5. Making sure all significant and unusual relationships are explained.	3.586

6. Making sure all major assumptions are fully described. 3.456

The scores indicate that, although reading narrative explanations is not very time consuming, it is an extremely important step that must be completed. These average scores, ranging from a low of 3.456 to 4.483, are as high as those for any other procedure.

The final procedure, test-checking of data to source documents,* was deemed to be the least important of any procedures performed by auditors. However, 75 percent of the respondents indicated that they performed test-checks. Those using this technique indicated that, on average, the tests consumed only 9 percent of total chargeable hours. Neither SAS 27 nor SAS 28 suggest the examining of source documents, and many accountants would consider this to be an "audit" procedure rather than a review technique.

To summarize, auditors use six specific procedures in complying with the requirements of SAS 27 and SAS 28. These procedures, together with their relative costs, are presented below:

	Percentage of Review Time	Approximate Costs*
Inquiring of Management and Other Client Personnel	23	\$1,185
Checking Mathematical Accuracy of Computations	21	1,082
Performing Reasonableness Tests	19	979
Comparing SFAS 33 Disclosures with Audited Financial Statements	16	825
Reviewing Narrative Explanation	11	567
Testing Checking Data to Source Documents	9	464
Totals	<u>100</u>	<u>\$5,154</u>

* These costs are estimated using the average 1982 costs as specified earlier in this report. The costs assume a homogeneity of tasks that likely will not exist because junior staff will spend more time on test-checking procedures while managers likely will make any inquiries.

Special Problems Encountered in Performing SAS 27 and SAS 28 Reviews

One of the major objectives of the research was to assist the auditing standard setting process by identifying SAS 27 and SAS 28 implementation problems. Auditors identified three major problems in complying with SAS 27

* Examples of such test checking would be to examine the documentation for the property schedules that are used to support the fixed asset amounts.

and SAS 28. The most common problem was that SAS 27 and SAS 28 are too general to provide much guidance. As a result, it is difficult to know when the data have been analyzed sufficiently. Typical comments were:

“It is difficult to know when to stop reviewing and yet be comfortable that no embarrassment will result to the client or my CPA firm from amounts disclosed.”

“It is difficult to determine the extent of ‘review’ procedures and to ascertain the propriety and reasonableness of indices used.”

A second problem identified was that the changing prices data are so subjective that no matter what procedures are performed, auditors can never feel comfortable with the data. Typical comments included:

“Determination of current cost of property and inventory are difficult to become comfortable with.”

“Objectively reviewing the assumptions and judgments is difficult considering the broad nature of assumptions and their limitations on companies with world-wide operations.”

The final major problem encountered was that, because changing prices disclosures are only supplementary to the primary financial statements and because they are unaudited, the disclosures are assigned a low priority by clients. As a result, the information is not available early enough to allow for meaningful evaluation. Typical responses were:

“Information necessary to generate data for SFAS 33 disclosures generally is not available early enough to allow for adequate time to generate meaningful data and allow adequate time to evaluate reasonableness.”

“The client has relatively little interest in the information and prepares it only to comply with GAAP. As a result, there is not a great deal of attention paid to the preparation of the information or the significance of the assumptions used.”

Auditor Perceptions Concerning Usefulness and Auditability of Changing Prices Data

The final objective of the research was to assess whether auditors perceive changing prices data to be useful to investors and creditors and whether or not disclosures should be audited. When asked whether or not they perceived the data to be useful, most auditors replied with an emphatic “no.” Typical of the responses received were the following:

“Changing prices information should not be required. They presume that inflation has an impact of similar latitude in each company’s financial statements. Business decisions are never based on these amounts to any great extent. Investors would have a very difficult time using this information to reliably predict earnings trends.”

“The confusion brought about by SFAS 33 is enough to warrant elimination of the disclosures.”

“SFAS 33 disclosures should be discontinued due to lack of tangible usefulness to investors and to other interested parties. It is an oversimplified means of presenting the implications of a very complex set of economic variables and events and, as a result, does not represent cost-beneficial information. The basic framework is not readily understandable.”

Particularly strong in their objection to the requirements were auditors of public utilities. Nearly all such auditors commented that, for public utilities, at least, the requirements are a waste of time. Several respondents indicated that, because public utilities are limited to recovering only historical costs through the rate-making process, the “lower recoverable amount” requirement causes PPE and inventory to be written up to current value and then written back down to historical cost.

The auditors responding to the questionnaire generally concurred, however, that if changing prices disclosures are to be mandated, then the accounting requirements should be more specific so that comparability among companies would be enhanced. Generally, auditors believe that SFAS 33 allows too many alternatives that result in inconsistent disclosures. These inconsistencies significantly reduce the usefulness of the information. Typical comments supporting this position were:

“SFAS 33 guidelines should have been specific in nature in order to allow for comparability of financial statements.”

“The FASB should reduce the number of acceptable accounting methods to avoid confusion and provide better consistency of the information.”

Although responding auditors were generally not supportive of any changing prices data, they did favor current cost disclosures over constant dollar disclosures. When asked which method they believed preferable for reporting to investors and creditors, nearly three times as many auditors responded that current cost disclosures are preferred. Although unsolicited, some respondents expressed their views with the following kinds of comments:

“The dual approach (constant dollar and current cost) should be eliminated in favor of current cost. A dual approach is confusing, and current cost is more appropriate.”

“The FASB should drop constant dollar reporting or allow companies to compute data based on indices representative of their business commitment.”

“The assumption of applying constant dollar indexes to complex multinational companies is so illogical that no one should base any judgments on the information.”

The final group of questions in the survey asked auditors their perceptions about the “auditability” of current cost and constant dollar disclosures and whether auditing the disclosures would make them more reliable to external users. Generally, auditors believed that data could be audited but that auditing would take considerably more time and would not make the data any more reliable to external users.

With respect to constant dollar disclosures and assuming the same

requirements of SFAS 33, 78 percent believe that, by conducting additional verifications and reviews of the indices and by checking more source documents and mathematical calculations, they could audit and render an opinion on financial statements that included such disclosures as a footnote. On average, auditors believe it would take 2.25 times as many chargeable hours to obtain the sufficient competent evidential matter necessary to audit such data. However, 88 percent feel that audited constant dollar disclosures would not be much more reliable to external users than the present unaudited supplementary disclosures. Those respondents who believe that the constant dollar disclosures could not be audited cited as their reasons the lack of specific GAAP, the complications of international operations, the use of too many assumptions and estimates, and the subjectivity of the data.

A much smaller percentage, 44 percent, believe that, given the same requirements as SFAS 33, it would be possible to audit and render an opinion on financial statements that included current cost disclosures as a footnote. Respondents who believe it would be possible to audit current cost data estimate that such procedures would take three times as long as current procedures and would require more detailed reviews of indices, more tracing to source documents, more checking of mathematical calculations, more analytical reviews, and more detailed testing of computer programs used to generate the data. Respondents who believe that current cost numbers could not be audited cited the use of too many assumptions and estimates and the subjectivity of the data as their primary reasons.

Both those who thought they could audit the data and those who believe it would be impossible agreed on one proposition—the audited data would not be much more useful to external users than unaudited disclosures. In fact, some respondents indicated that, by leading financial statement users to believe the information is more accurate than it really is, auditing might make the data even more confusing.

In summary, most auditors stated that the present constant dollar and current cost disclosures are confusing, subjective, and not very useful. They indicated that current cost disclosures are more meaningful than constant dollar disclosures but do not want to see expanded standards, such as a requirement that the data be audited.

Conclusions

Based on an analysis of the accumulated data, the following conclusions have been reached:

- There is little perceived client interest in changing prices disclosures. Auditors do not perceive such disclosures to be used by internal management; rather, the disclosures are provided only to meet the minimum FASB disclosure requirements.

Of those auditors surveyed, 87 percent indicated that their clients have little interest in changing prices disclosures. Many comments were received indicating that, because of confusion about their meaning, changing prices data are not considered when making decisions.

Seventy-three percent of the auditors indicated that their clients provided the disclosures only to meet the requirements set forth in SFAS 33. In meeting

these minimum disclosures requirements, most companies use the easiest method available for calculating the current costs of property, plant, equipment, and inventories. Published indices are used by 59 percent of the responding companies in valuing PPE while 53 percent indicate that they base the current cost of inventories on FIFO.

- The average review of changing prices disclosures requires a small percentage of engagement time and results in minor adjustments to the disclosures. Departures from SFAS 33 guidelines ordinarily are not material enough to justify modifying auditor reports.

In 90 percent of the cases, the auditors' review of changing prices disclosures consumed less than two percent of total engagement time. This amounted to less than \$5,200 per client based on assumed costs in 1982. Senior staff members were most often involved; partners had relatively little involvement in reviewing the disclosures.

As a result of these reviews, several minor adjustments were made to the changing prices disclosures. These adjustments usually involved correcting clerical errors. None of the respondents reported having to modify audit reports because of material omissions or material departures from SFAS 33 guidelines.

- Although few formal audit-type programs exist for reviewing changing prices disclosures, CPAs use the following specific procedures in fulfilling their responsibilities: inquiring of management, checking mathematical accuracy, performing reasonableness tests, comparing SFAS 33 disclosures with audited financial statements, reviewing narrative explanations, and test-checking data to source documents.

Inquiring of management is considered the most important step in reviewing changing prices disclosures. This procedure consumes almost one quarter of all chargeable hours related to reviews of SFAS 33 disclosures. When conducting these inquiries, the senior accounting staff and controllers of clients are most often contacted.

Almost all auditors perform mathematical checks of computations and spend 21 percent of chargeable hours on this activity.

Various reasonableness tests relating to changing prices data have been developed by CPA firms. These tests are applied by 87 percent of auditors and are responsible for almost one fifth of chargeable hours relating to SAS 27 and SAS 28 reviews.

Another procedure always performed by auditors, comparing changing prices disclosures with audited financial statements, accounted for 16 percent of chargeable hours.

Although reviewing narrative explanations does not consume as much time as other procedures, it is considered by most auditors to be one of the most important. Management's narrative explanations are reviewed mainly for material misstatements, omissions, and inconsistencies.

Test-checking data to source documents was the least important procedure performed by the auditors.

- Several problems associated with reviewing changing prices disclosures were identified by auditors. The problems mentioned most often were: SAS 27 and SAS 28 standards are too general, changing prices data are too subjective, and complying with the requirements is assigned low priority by client companies.

The procedures suggested in SAS 27 and SAS 28 provide few specific details for auditors to follow in conducting their reviews. Consequently, auditors feel uncomfortable with the review process.

The second problem, subjectivity of changing prices data, is a result of the

flexible guidelines of SFAS 33. This statement allows changing prices data to be computed using a variety of methods and assumptions. Many auditors commented that, if changing prices disclosures are to be effective, more specific reporting guidelines must be provided.

Because of the low interest expressed to the respondents by clients concerning the changing prices data, the disclosures are seldom prepared in a timely manner. Clients apparently generate the data as a compliance procedure, not for use by management.

- Auditors responded that the present reporting guidelines, requiring disclosures based on both constant dollars and current costs, are confusing, subjective, and not very useful. They stated that current costs are more meaningful than constant dollar disclosures. However, auditors indicated that requiring changing prices data to be audited would not necessarily result in more useful information for external users.

Many comments were received suggesting that requiring information based on both constant dollars and current costs results in compromising the usefulness of both sets of data. Because each method includes different assumptions, the disclosures are confusing when reported with primary financial statements, which use yet another set of assumptions.

Of those auditors expressing a preference, over 70 percent prefer current cost to constant dollar disclosures. Although auditors feel that neither method should be subject to an audit requirement, they indicated that the current cost method results in information that is more relevant to financial statement users.

Endnotes

1. Statement of Financial Accounting Standards No. 33, "Financial Reporting and Changing Prices" (Stamford: Financial Accounting Standards Board, September 1979). SFAS No. 33 requires most large companies to provide supplemental financial data reflecting price changes. Two methods are used to disclose this information. The first deals with changes in the general price level for all commodities and services. This method is known as constant dollar accounting. The second kind of price change relates to changes in prices of particular items. This second method is referred to as current cost accounting.

2. Statement on Auditing Standards No. 27, "Supplementary Information Required by the Financial Accounting Standards Board," AICPA Professional Standards, 1979 and Statement on Auditing Standards No. 28, "Supplementary Information on The Effects of Changing Prices," AICPA Professional Standards, 1980. SAS No. 27 requires auditors to apply certain procedures to supplementary information required by the FASB. Those procedures include inquiring of management regarding methods of preparing information, comparing the information for consistency with audited statements and management's response to inquiries, and applying additional procedures required by other FASB statements. SAS No. 28 requires that the procedures in SAS No. 27 be specifically applied to a company's changing prices disclosures.